DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, LM:HMT:

FROM: Heather C. Maloy
Associate Chief Counsel
(Income Tax & Accounting)

SUBJECT:

This Chief Counsel Advice responds to your memorandum dated April 17, 2002. In accordance with § 6110(k)(3) of the Internal Revenue code, it should not be cited as precedent.

LEGEND

Taxpayer A =
Taxpayer B =
Taxpayer C =
League =
Team =
State =
City 1 =
City 2 =
County =
Statute =
Park =
Term =
x =
Agreement =
Old Stadium =
Fund =
$N =
$O =
$P =

$Q	=	
$R	=	
$S	=	
$T	=	
$U	=	
$V	=	
$W	=	
$X	=	
$Y	=	
$Z	=	
Year 1	=	
Year 2	=	
Year 3	=	
Year 4	=	

ISSUES

1. Whether Taxpayer B must include in gross income the proceeds from the sale of personal seat licenses conducted by Authority, which used the proceeds to offset a part of B's obligation to fund construction costs of a new stadium? 61.29-00

2. Whether Taxpayer B, an accrual method taxpayer, must include in income in Year 1 the total sales proceeds of the personal seat licenses sold under an Agreement executed in Year 1, although additional installment payments under the Agreement were due in Year 2 and in Year 3? 451.13-00; 451.19-00

CONCLUSIONS

1. Taxpayer B must include in gross income the proceeds from the sale of the personal seat licenses.

2. Taxpayer B should report the income when each installment becomes due and payable, or each installment is received, whichever happens first.

FACTS

Taxpayer A owns x percent of the outstanding stock of Taxpayer B, which holds the professional League franchise for the Team. For Year 1, Taxpayer A filed a consolidated federal income tax return that included Taxpayer B. In Year 2, Taxpayer A elected to file as an S corporation. Consequently, Taxpayer B became the common parent for the affiliated group and filed consolidated returns beginning with Year 2. Both Taxpayer A and Taxpayer B employed the accrual basis of accounting for tax purposes.

Taxpayer B began to pursue the construction of a new stadium in City 1 to keep the Team competitive with other teams in the League. A new stadium would incorporate many features lacking at Old Stadium and generate additional revenue streams from sources such as luxury suites and club seating. During Year 1, Taxpayer B was able to work out a plan with local governmental authorities to fund a new stadium. Under the plan, Taxpayer B was to be responsible for the construction of the stadium, which was to be owned by a local public authority but leased to Taxpayer B. In Year 1, a Memorandum of Intent setting forth the terms of the plan was executed between Taxpayer B and a public auditorium authority for City 1 and County (Authority). It was contemplated that the parties would negotiate definitive agreements reflecting the parties' understanding of the terms.

The Memorandum of Intent indicated that Taxpayer B's contribution toward the stadium project would include, among other funds, approximately $N (but not less than $O) in net proceeds from the sale of personal seat licenses, along with accrued interest thereon. The Team's obligations in this regard, however, were contingent upon a successful completion of the sale by , Year 2. Any proceeds in excess of $N from the personal seat licenses were to be allocated to any shortfalls or project cost overruns incurred by the Authority, and then to project cost overruns that were the responsibility of Taxpayer B.

Subsequent negotiations resulted in some changes to the terms of the plan as originally reflected in the Memorandum of Intent. Formal written agreements were executed by the parties in Year 3.

The sale of personal seat licenses, which were technically referred to as "stadium builder licenses," began in Year 1. The sale was well received by Taxpayer B's long-time season ticket holders and raised $P.[1] Per the license agreement, the Authority was the nominal licensor.[2] The agreement provided, however, that the Authority would assign its interest in the licenses to Taxpayer B upon completion of the stadium, when the stadium itself was to be sub-leased to Taxpayer B. The term of the licenses correspondingly commenced on the date that construction of the stadium was completed and continued for so long as the Team played games at the stadium. A one-time license fee was payable by the licensees in three installments, which were due in Year 1, Year 2, and

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[1] The season ticket holders purchased more personal seat licenses than were anticipated. Total proceeds from the sale amounted to $P, of which $Q was received in Year 1, $R in Year 2, and $S in Year 3.

[2] The examining agent has not uncovered any written agreement authorizing the Authority to sell the right to tickets to Team games.

Year 3. The payments were made to a Fund , an account established by the Authority to be used exclusively to finance the design, development, and construction of the stadium. If the stadium was not completed for any reason, all payments made by the licensees would be refunded to them without interest.

Per the license agreement, the personal seat licenses entitled the licensees to buy tickets to all future Team games to be played at the new stadium. The licenses did not grant the licensees any ownership or other equity interest in the stadium or the Team. The license agreement expressly states that the licensees had only a revocable right of personal privilege and that the licenses did not confer any real property or leasehold interest in any particular stadium seats.

There are indications that in Year 1, just prior to the sale of the personal seat licenses, Taxpayer B filed for a waiver with the League to retain the visiting teams' share of the proceeds from the sale. Under League rules, ticket receipts are to be shared between the home and visiting teams. Generally, the home team receives x percent of ticket receipts, and the visiting team is entitled to the balance. It should also be noted that the League’s collective bargaining agreement with its players' union generally includes the proceeds from the sale of personal seat licenses in team revenues for a variety of purposes, including the salary cap.[3] A special exemption is provided, however, for personal seat license proceeds used exclusively to build a new stadium that is not owned by the team or an affiliate.

To facilitate construction of the new stadium, Taxpayer B created a wholly-owned subsidiary, Taxpayer C. Groundbreaking for the stadium occurred in the late summer Year 2, with construction to be completed by Year 4. An Agreement was executed by Taxpayer C and the Authority on , Year 3. Taxpayer C was designated as the "developer" authorized to act as sole and exclusive agent for the Authority with respect to the design and construction of the stadium. The Authority was to hold title to the stadium, which was to be leased to Taxpayer C and then subleased to Taxpayer B. Taxpayer C was obligated to provide financing toward the stadium project of not less than $T. The Authority was required to contribute a sum not to exceed $U, while State was committed to providing funds in the total amount of $V. Taxpayer C was obligated also to cover all cost overruns related to the design and construction of the stadium.

By the terms of the Agreement, the amount of $W from the sale of the personal seat licenses, together with accrued interest thereon up to $X, was credited toward Taxpayer C's required contribution of $T. The proceeds from the sale of the personal seat licenses in excess of $W, amounting to $Y (together with interest

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[3] Maximum amount that a League team can spend on players' salaries, set at a percentage of designated team revenue.

accruing on the deposited funds over $X), were allocated to future cost overruns, if any, which Taxpayer C was required to cover. The Authority's obligations under the agreement were contingent upon Taxpayer C providing funding of $T, inclusive of the proceeds from the sale of personal seat licenses. Taxpayer C's obligations under the agreement were likewise contingent upon the Authority providing funding of $U. The Authority was to meet its financial commitment by floating a bond issue. In the event of a relocation of the Team' franchise to another city, Taxpayer C was required to repay the Authority an amount equal to the Authority's required contribution, including principal, interest, and other sums necessary to retire any bonds that were issued. The State's portion of the stadium funding was made pursuant to a Statute, enacted , Year 2.

A stadium lease agreement between Taxpayer C and the Authority, also executed on , Year 3, ran for Term. Taxpayer C agreed to make three payments of "statutory rent," as provided by Chapter 5 of the Statute.[4] The "statutory rent" was payable to the Authority, which was to remit the payments to the State. The "statutory rent," payable upon expiration of each 10-year period of the lease, amounted to $Z, subject to reduction for credits based upon increases in certain tax revenue generated by the operation of the new stadium. Taxpayer C also agreed to manage and operate all aspects of the stadium and was responsible for all operating expenses and the costs of ordinary maintenance and repairs. In return, Taxpayer C retained x percent of the revenue from sporting events and related activities (such as concessions, luxury suites and club seats, in-stadium advertising, and naming rights) and x percent of the net revenues from non-sporting events held at the stadium. The City, County, and the Authority reserved the right, collectively, to use the stadium for up to three civic, cultural or community events each year without charge and with the right to retain all proceeds from these events.

Taxpayer B agreed to guarantee all of the obligations of Taxpayer C arising from the various agreements with the Authority, including the Agreement.

None of the proceeds from the sale of the personal seat licenses was included in Taxpayer B's income in Year 1 (on the consolidated return filed by Taxpayer A) or in subsequent tax years. Also, for tax purposes, Taxpayer B did not take any deduction for funds that it expended for construction of the new stadium. Rather, the expenditures were accumulated in an asset account captioned "stadium development."

[4] Taxpayer B joined in the execution of the primary lease solely for the purpose of acknowledging that it was bound by the provisions of the lease to the extent required by Chapter 5 of the Statute.

The consolidated tax returns filed for Year 1 and Year 2 are under audit. The examining agent proposes to increase gross income in Year 1 by the amount of the proceeds generated by the sale of the personal seat licenses.

LAW AND ANALYSIS

Issue 1.

Under § 61 gross income means all income from whatever source derived, unless otherwise provided by law. The Supreme Court of the United States has long recognized that the definition of gross income sweeps broadly and reflects the intent of Congress to exert the full measure of its taxing power and to bring within the definition of income "any accession to wealth." See Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429 (1955); United States v. Burke, 504 U.S. 229, 233 (1992).

It is beyond cavil that the payment of a taxpayer's obligation by a third party pursuant to an agreement between them results in income to the taxpayer. Douglas v. Willcuts, 296 U.S. 1 (1935); Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929). See also Ferro v. Commissioner, 242 F.2d 838 (3d Cir. 1957). In Old Colony Trust, an employer paid the taxes due on the salaries paid to its officers, including its president. The Commissioner determined that the recipients were required to include the payment of taxes in their respective gross income as additional salary. In sustaining the determination of the Commissioner, the Court opined "[t]he discharge by a third person of an obligation to him is equivalent to receipt by the person taxed." Old Colony Trust Co., 279 U.S. at 729. The Court found immaterial the fact that the employee never received the taxes because they were paid directly over to the Government. The Court regarded the transaction as being the same in substance as if the taxes had been paid to the taxpayer who then transmitted them to the Government. This principle applies with equal force to the facts of the instant case.

Under the Memorandum of Intent and the Agreement, Taxpayer B and subsequently Taxpayer C was obligated to provide $T for construction of the Stadium. A portion of this commitment was to be discharged by $N received from the sale of the personal seat licenses. Any amount in excess of $N received from the sale of the licenses was to be used to defray cost overruns, for which Taxpayer C was also responsible. By applying the proceeds of sale to discharge its obligation to partially fund construction costs, Taxpayer C has derived an economic benefit and must recognize income in that amount.

We do not believe the fact that the sale was conducted by the Authority is material or requires a different conclusion. Revenue from the sale of personal seat licenses belongs to the individual teams in the League. This revenue is considered owned by the individual team for many purposes, including the determination of the annual salary cap on salaries paid to the players. Moreover, while we do not believe it conforms to reality, the Authority agreed to assign its "interest" in the licenses to Taxpayer B upon completion of the Stadium. We view this assignment as a mere attempt to imbue with substance the notion that the Authority actually owned rights in the personal seat licenses.

Issue 2.

Section 451(a) provides that the amount of any item of gross income shall be included in gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Income Tax Regulations states, in part, that under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. See also § 1.446-1(c)(1)(ii)(A). All the events that fix the right to receive income occur when (1) the required performance occurs, (2) payment therefor is due, or (3) payment therefor is made, whichever happens earliest. Rev. Rul. 84-31, 1984-1 C.B. 127. See also Schlude v. Commissioner, 372 U.S. 128, 133 (1963).

The field contends that income from the personal seat licenses should be reported by Taxpayer B in Year 1, the year the license agreement was executed. The field's argument seems to assume that the sale of the personal seat licenses occurs in Year 1, establishing the required performance under the all-events test. The determination of when a sale occurs is essentially a question that requires consideration of all the facts and circumstances of a particular situation. Clodfelter v. Commissioner, 426 F. 2d 1391, 1393-1394 (9th Cir. 1970); Commissioner v. Segall, 114 F. 2d 706, 709 (6th Cir. 1940); Baird v. Commissioner, 68 T.C. 115, 124 (1977). A factor to consider in determining whether a sale has occurred is whether under the contract the seller has an unqualified right to receive the contract price. Lucas v. North Texas Lumber Co., 281 U.S. 11, 13 (1930); Commissioner v. Union Pacific R.R. Co., 86 F.2d 637, 639 (2d Cir. 1936). Other factors to be considered in determining when a sale occurs are when legal title to the property is transferred and when the benefits and burdens of ownership of property are shifted from the seller to the buyer. Merrill v. Commissioner, 40 T.C. 66, 76 (1963), aff'd per curiam, 336 F. 2d 771 (9th Cir. 1964).

A sale, for tax purposes, must result from a closed transaction. The court in Union Pacific R.R. Co., above, defined a closed transaction as follows:

> A closed transaction for tax purposes results from a contract of sale which is absolute and unconditional on the part of the seller to deliver to the buyer a deed upon payment of the consideration and by which the purchaser secures immediate possession and exercises all the rights of ownership. The delivery of a deed may be postponed and payment of part of the purchase price may be deferred by installments; but for taxing purposes it is enough if the vendor obtains under the contract the unqualified right to recover consideration.

The taxpayer in Union Pacific R.R. Co., whose books were kept on an accrual basis, sold two parcels of real property. Even though the contracts of sale involved deferred payments, the court concluded that the sales had occurred at the time the contracts were executed rather than the year when the payments were made. The court regarded the transactions as closed in the year the contracts were executed because at that time the seller had the unqualified right to recover the consideration. Similarly in Elsinore Cattle Company v. Commissioner, No. 17,516 (T.C.M. 1950), which involved when the sale of real property under an "Agreement of Sale and Purchase of Property" took place, the United States Tax Court found that the contract reflected a closed sale on the date it was executed because: (1) the amount of and right to the purchase price were fixed and unqualified; (2) the obligation to convey title on payment was absolute and enforceable; (3) complete dominion and control over the property passed to the purchaser on the stated date; (4) thereafter all the benefits and burdens of ownership were enjoyed or assumed by the purchaser; and (5) after the basic date equitable title resided in the purchaser, leaving the vendor bare legal title that it agreed to convey on final payment (10 years after the contract was executed).

If, however, the contract of sale is executory so that transfer of title and full payment are made conditions to the completion of the transaction, a sale does not occur for tax purposes until the conditions are satisfied. In Lucas v. North Texas Lumber Co., the taxpayer gave another a 10 day option to purchase its timber lands for a specified price on December 27, 1916. On December 30, 1916, the buyer notified the taxpayer that it would exercise the option. On January 5, 1917, the papers required to effect the transfer were delivered, the purchase price was paid, and the transaction was finally closed. The court stated at 13:

> An executory contract of sale was created by the option and notice, December 30, 1916. In the notice the purchaser declared itself ready to close the transaction and pay the purchase price "as soon as the papers were prepared." Respondent did not prepare the papers necessary to effect the transfer or make tender of title or possession or demand the purchase price in 1916. The title and right of possession remained in it until the transaction was closed. Consequently

> unconditional liability of vendee for the purchase price was not created in that year.

In the situation presented, unconditional liability of the licensee for the entire purchase price is not created in Year 1. Instead, the licensor has a right to collect the purchase price of the personal seat license only as installments become due and payable under the license agreement (or as the installments are actually received). Although upon default the licensor can keep all payments received under the agreement, the licensor cannot compel payment of any future installments not yet due. Thus, there is no closed transaction in Year 1 for the sale of a personal seat license. Further, the license agreement provides that a personal seat license is granted to the licensee for and in consideration of the payment of the personal seat license fee. Stated otherwise, until a licensee pays the last installment due under the agreement, the personal seat license remains with Taxpayer B[5].

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

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5 [redacted]

[redacted]

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Please call if you have any further questions.